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July 11, 1996

Ex Parte

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
1919 M Street, NW, Room 222
Washington, D.C. 20554

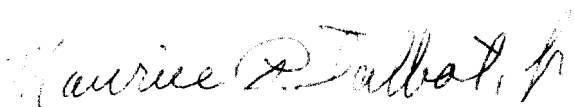
Re: ExParte CC Docket No. 96-112, Allocation of Costs Associated with
LEC Provision of Video Programming Services

Dear Mr. Caton:

Yesterday, T. Seaton, R. Blau, L. Darby, and the undersigned, representing BellSouth, met with Dr. J. Farrell, Chief Economist, and Dr. Pepper, Chief, Office of Plans and Policy to discuss BellSouth's position regarding the above-referenced proceeding. The attached documents represent the basis for the presentation and discussion and is consistent with BellSouth's position in this proceeding.

In accordance with Section 1.1206(a)(1) of the Commission's rules, two (2) copies of this notice are being filed with the Secretary of the FCC. Due to the lateness of this meeting this filing is being made the day after the meeting

Sincerely,



Maurice P. Talbot, Jr.
Executive Director - Federal Regulatory

cc: Dr. J. Farrell
Dr. R. Pepper

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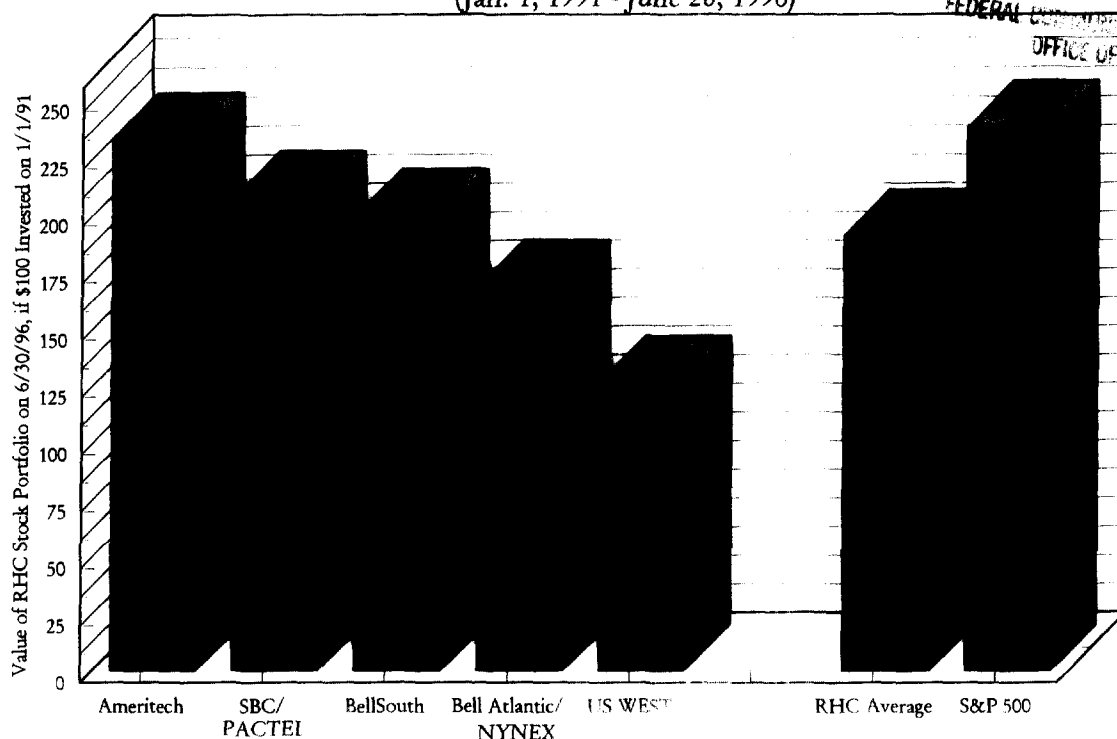
In Recent Years, Shareholders Have Been Penalized by RHC Decisions to Invest Larger Portions of Their Available Cash Flow in Regulated Local Wireline Networks.

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Regional Bell Company Total Shareholder Return Index (Jan. 1, 1991 - June 28, 1996)

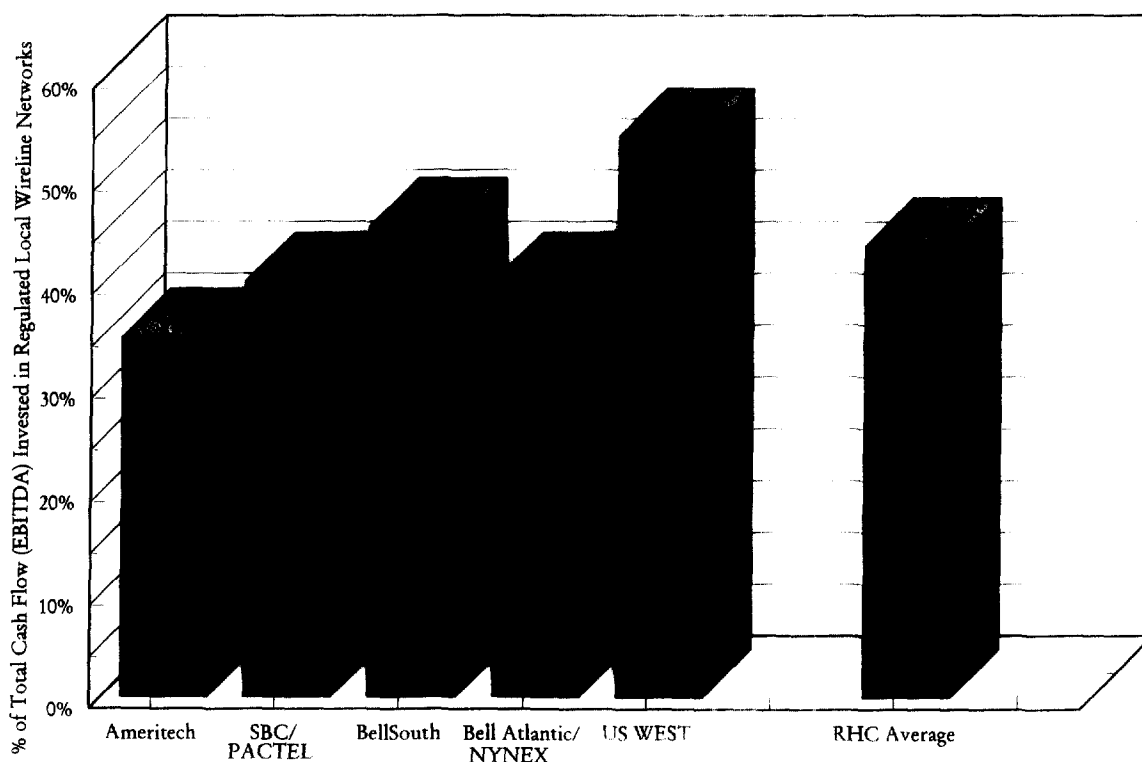
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Source: One Source

Regional Bell Company Capital Expenditures on Local Wireline Networks, as a Percentage of Total Cash Flow: (1991 - 1995)



Source: CompuServe

Chart 2

Note: Shareholder returns for RHC average and for SBC/Pactel and Bell Atlantic/NYNEX Composites are based on marked weighted averages.

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EX PARTE MEETING

VIDEO PROGRAMMING SERVICES
CC DOCKET NO. 96-112

JULY 10, 1996

Summary and Conclusions

Record is insufficient to judge impact on investment and video competition

No market model; no theory of investment and regulation

Insufficient data to evaluate impact of investment and innovation

Old investment models not applicable

Minimal carrier incentive/opportunity to practice "predatory" cross-subsidy

Guarding against cross-subsidy through cost allocations may reduce investment

Consumers' interests extend to both telco and cable services market

Commission can increasingly rely on competitive markets to protect the public

1. Commission must balance several goals under the new law

Promote competition

Encourage investment and innovation

Increase consumer choice

Reduce regulatory intrusion

Assure just and reasonable rates for regulated services

2. Commission goals (NPRM paras. 22 and 24)

Comply with Act's provisions to:

facilitate offer of competitive telecom services

promote telco entry into video distribution and program services markets

ensure just and reasonable rates

administrative simplicity

adaptability to technological change

uniform application

consistency with economic principles of cost causation

New goals and new public interest definition requires

explicit statement of goals and weights

3. Conclusions respecting cost allocation

Cost causation not estimable or verifiable

Common cost allocations:

are completely arbitrary, but

are implicitly purposive

will have substantial impact on other statutory goals

investment and innovation

competition, consumer choice and program diversity

4. Threat of cross-subsidy increasingly remote

Regulatory protections against cross-subsidy are unnecessary

Price caps eliminate regulatory incentives to practice uneconomic cost-shifting

Implementation of 1996 Act will eliminate residual opportunities

Cross-subsidy detracts from shareholder value in present environment

If used to reduce rates, regulatory allocations may well:

- reduce telco investment incentives; reduce broadband innovations
 - reduce competition in video services; reduce diversity and choice
- 5. Record not complete with respect to investment implications of proposals
 - No connection between regulation and investment incentives/opportunities
 - No models, no data, no theory, basis for assessing impact on
 - video competition
 - consumer alternatives
 - investment and innovation
 - Parties cannot verify Commission analysis with models and data
- 6. Economic welfare in this proceeding is complex
 - Consumers have stake in development of all markets
 - Telephone services
 - Video services
 - Other digital and data applications
 - Interests of telephone "ratepayers"
 - extends to all services
 - has both short and long run dimensions
 - Economic welfare not advanced by protecting ratepayers, if
 - rate of investment and innovation is diminished
 - competition to cable systems is diminished
 - consumers have fewer options
- 7. Cost allocation as regulatory tool is nearly obsolete and certainly risky
 - Only markets can "efficiently" allocate common costs
 - Market allocations cannot be prospectively emulated by regulators
 - Incorporation of regulatory errors in rates will lead to
 - resource misallocation
 - reduction in investment
 - reduction in benefits from competition in video market
 - fewer options, lower quality, higher prices for unregulated services
- 8. The A-J-W model of predatory cross-subsidy no longer applies
 - No rate of return constraint; or, evidence that earnings exceed cost of capital
 - Decoupling of prices and costs under price caps:
 - eliminates incentives to burden users of regulated services
 - assures shareholders are penalized for excess costs/wasteful investment
 - Historically regulated markets are increasingly "contestable" (Viz., Dkt. 96-98)
 - Losses in one market cannot be recovered in other markets now, or in the future
 - Predatory cross-subsidy cannot be defended to shareholders
 - No evidence that shareholder value is created by predatory cross-subsidy
- 9. Markets assure that regulated services users will benefit from economies of scope
 - Consumers have diverse interests
 - Price, quality, diversity
 - Current and future concerns
 - Consumers:
 - are multiservice users -- voice, video and data
 - have a stake in development of diversified networks
 - may not be served by narrow policies focused on voice

10. Exogenous treatment under price caps of carrier investment arbitrarily allocated:
 - Is inconsistent with past practice and policies
 - Is inconsistent with the clear statutory mandate
 - Will penalize shareholders for investing in dual purpose plant
 - Will discourage competition, investment and deny consumer options
 - Will be a factor in carriers' broadband investment decisions

11. To identify public interest in this proceeding, the Commission should
 - Consider current investment incentives/abilities of telcos and cable
 - Develop models to determine impact of costing alternatives on those incentives
 - Perform analyses of differential policy impacts on policy goals
 - competition in video services
 - investment in broadband networks
 - diversity and quality of consumer broadband options
 - consumers broad interests in network services and as voice users

12. There is no basis in fact or theory for the NCTA fixed allocation proposal

13. Commission may make two kinds of errors with different impacts
 - Type I Error -- Regulate costing when it is not needed
 - Type II Error -- Fail to regulate costing when it is needed
 - Unnecessary and misconceived costing will have serious impacts

14. New statutory goals, past regulatory reforms and emerging competitive market structures require new regulatory objectives, new models and new methods of analysis.